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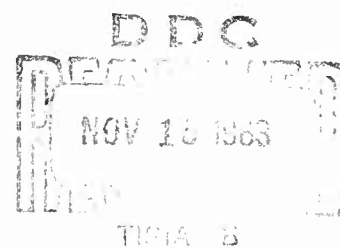
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DIVERGENCES BETWEEN INDIVIDUAL AND TOTAL COSTS WITHIN GOVERNMENT

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DIVERGENCES BETWEEN INDIVIDUAL AND TOTAL COSTS WITHIN GOVERNMENT*

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It is a bit surprising to realize what different attitudes we have toward the private and public portions of the economy. This contrast is particularly marked with respect to divergences between individual and total costs or gains. By such divergences I mean differences between costs and rewards as perceived by decision makers and total costs and rewards produced by their actions. These differences are often called external economies and diseconomies or, more briefly, spillover effects. They are impacts on others that are not taken into account by managers or individuals who take action.

Let me review our attitudes toward the two sectors in this respect. In the private sector we have assumed, first of all, that individuals are utility-maximizers. We have not claimed any precise knowledge of individuals' utility functions but have concluded that utility must be a function of many desired items, that there are tradeoff or substitution possibilities among these items, and that, if one becomes more expensive relative to others, less of that item will be demanded. On

* I am greatly indebted to the Social Science Research Council for an award that made possible a larger study of governmental processes, from which the present paper stems.

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this foundation, we have constructed most of economic theory, including many testable hypotheses.*

In this connection, we have believed that a producer recognizes costs he has to pay but is unlikely to recognize damages or resources used up for which he does not have to compensate anyone. He would have to sacrifice too many other things to make unnecessary compensations. For similar reasons we have assumed that a producer recognizes benefits for which customers compensate him but is unlikely to count other benefits that he does or could produce. Again it would be too costly in terms of other objectives. Indeed in a moderately competitive industry the sacrifice entailed by a highly altruistic attitude would be bankruptcy. We have not meant, of course, that people always pursue self-interest narrowly defined. Rather we have meant that the higher the cost of pursuing one objective, the less of it one will try to achieve. Thus the more personal gain one sacrifices to be altruistic, the less altruism he will pursue. And the greater the divergence between individual and total costs and gains, the less likely one is to be guided by total costs and gains.

Secondly, with respect to the private sector we have written and talked a great deal about ways to define property rights better, or about other ways to intervene, so as to induce people to take total costs and gains into account. In this writing and talking, a variety of issues has been explored. It has generally been accepted that it is not desirable for people to take pecuniary spillover effects into account. And some economists, especially Ronald Coase, have stressed that the cost of government intervention should itself be recognized -- that divergences between individual and total costs in the private

*The clearest discussion of these points that I know of is in an unpublished economics textbook by Armen A. Alchian. See also Armen A. Alchian and Reuben A. Kessel, "Competition Monopoly, and the Pursuit of Money," in Aspects of Labor Economics, A Report of the National Bureau of Economic Research, Princeton University Press, Princeton, N.J., 1962, pp. 157-183, and Gary S. Becker, The Economics of Discrimination, University of Chicago Press, Chicago, 1957.

sector do not call for government intervention unless it would actually do more good than harm.* In any event, we have given quite a bit of attention to external economies and diseconomies in the private sector and what to do about them.

Thirdly, it has not been uncommon to conclude that activities should be transferred to the public sector if serious divergences cannot be eliminated. As cities developed, for instance, it became obvious that private decisions had important spillover effects on other persons. Many concluded that the only thing to do was to have governments plan cities or, as cities grew older, plan their renewal. Flood control and education are also examples of activities that had significant external effects -- divergences between individual and total costs and gains -- and were placed to a considerable extent in the public sector. I am not suggesting that this was obviously a wrong solution -- I am merely saying that we do often decide to turn to government in such instances. And even where lesser spillover effects occur, it is sometimes implied that, because the market system has "failed," the activity should be conducted by government.

In the public sector, however, our attitude has usually differed from the above. First, many persons have tended to assume, unconsciously for the most part, that public officials are public-interest maximizers. In other words, we have assumed that government personnel pursue one type of gain and avoid one type of cost -- those felt by the general public -- and ignore other variables that would normally be in utility functions. To be sure we have recognized the existence of outright graft and corruption, attributing this to government personnel of another extreme variety -- selfish-interest maximizers whose utility functions include a number of evil aims and little else. These evil men seem to be regarded as the exceptions that prove the general rule of public-interest maximizing. For some reason we have tended to

* Ronald H. Coase, "The Problem of Social Cost," Journal of Law and Economics, October 1960, pp. 1-44.

neglect the intermediate possibilities: government officials who are ordinary utility-maximizers, with many items in their utility functions, with substitution possibilities existing among these items, and with negatively-sloped demand curves for each of these items. (Or, alternatively, government officials who are assumed for analytical purposes to have a smaller number of specific, though not wicked, aspirations.)

Second, given the above attitude, economists have naturally enough talked little about manipulating the costs of objectives sought by public officials so as to affect their behavior. We have talked little about rigging individual costs and rewards in government to make them more nearly consistent with total costs and rewards. Students of public administration and political science have searched for improvements in governmental organization, of course, implicitly seeking ways to bring individual criteria closer into line with higher-level criteria. Economists, however, have not given much attention to bargaining processes in government, the resulting cost-reward structures confronting officials, or ways to influence those cost-reward structures.*

* In recent years, though, there has been growing interest in economics as well as other social sciences in studying organizational behavior from vantage points of this sort. Some of the more directly relevant efforts are Armen Alchian's work on the implications for behavior of various kinds of property rights; E. C. Banfield, Political Influence, Free Press, Glencoe, Illinois, 1961; James Buchanan and Gordon Tullock, The Calculus of Consent, University of Michigan Press, Ann Arbor, 1962; R. A. Dahl and C. E. Lindblom, Politics, Economics, and Welfare, Harper & Brothers, New York, 1957; George C. Homans, Social Behavior: Its Elementary Forms, Harcourt Brace, New York, 1961; C. E. Lindblom, Bargaining: The Hidden Hand in Government, The RAND Corporation, RM-1434, 1955; Mancur Olson, Jr., A General Theory of Public Goods, March 1963 (unpublished manuscript); William Riker, Theory of Political Coalitions, Yale University Press, New Haven, Conn., 1962; Jerome Rothenberg's work in process on models of government behavior; Herbert A. Simon, Administrative Behavior, 2d ed., Macmillan Co., New York, 1961; J. G. March and H. A. Simon, Organizations, Wiley & Sons, New York, 1958; and Gordon Tullock, A General Theory of Politics (unpublished manuscript).

Also, this way of looking at organizational behavior, while often neglected, goes back a long way. For a review of the interest of one famous political economist in this subject, see Nathan Rosenberg, "Some Institutional Aspects of The Wealth of Nations," Journal of Political Economy, December 1960, pp. 557-570.

Third, and again it is natural enough in view of the preceding remarks, we have rarely concluded that, because of gross divergences between individual and total costs or gains within government, certain activities should be shifted to the private sector. Again I am not suggesting that our policies have obviously been wrong -- it simply strikes me as being a curious asymmetry in our thinking.

Or does each government official, in choosing his actions, weigh total gains to everyone against total costs to all? Is he unwilling to trade part of this objective for some degree of achievement along other lines? It may be true that public servants aim to promote the general interest more consistently than most other samples of the population. There is a selection process in the flow of personnel into any occupation, and those who choose public life may well be less selfish than most others. Nonetheless it is unlikely that there is a sharp distinction between these two populations, especially since there are numerous transfers back and forth. Government officials too are surely utility-maximizers. They may attach less weight than others do to personal costs and gains and give greater consideration to the costs and benefits bestowed on strangers. But still, the greater the cost of achieving one aim, the less of it they will try to achieve -- the greater the divergence between private and total costs, the less likely they are to reach decisions in the light of total costs. Moreover, to stay in office or to survive in the bureaucratic struggle, one cannot ceaselessly strive for the public interest. As in the competitive model, the cost is bankruptcy, this time career bankruptcy. The best one can hope for is that on balance he is "doing good" while compromising on many individual issues. A public official may not ask, "what can GNP do for me today?" but neither does he ask each morning, "what can I do for GNP?"

Even if civil servants and politicians do not constantly look at total costs and gains, however, are there serious divergences in government between private and total costs or gains? After all, there is a mechanism in any organization that forces each member to take into account many effects that might otherwise be externalities. This

mechanism is the bargaining process, and it is crucial in making costs and gains felt by decision makers in the public sector. It is similar in certain respects to the price mechanism, which is crucial in making costs and gains felt by decision makers in the private sector. When a business firm takes action, it has to bargain with and compensate numerous persons who supply buildings, labor services, and other inputs. That is, if the firm's action uses up or damages property, the firm has to buy the consent of the owners. Wherever the firm's action has beneficial effects, the management tries to charge the beneficiaries. The greater the extent to which all these compensations are made, the less the extent to which the firm's costs and gains will diverge from total costs and gains. In government, similarly, if one official's action will use up someone's property or damage their interests, the official will probably find a cost associated with the action. He may endure embarrassing or expensive enmities, or suffer costly retaliations. One way or another he will have to bargain and pay a price, the size of which will depend on bargaining strengths and circumstances. If an official's action benefits a colleague or group, he will be able to bargain, tacitly if not explicitly, for some kind of quid pro quo. Thus the bargaining process can work in the direction of making individual costs and gains more nearly reflect total costs and gains.

In this grossly imperfect competition, however, the process does not work with much precision. Individual consumers have no incentive to put much effort into bargaining, for example, while advocates of tariffs, silver subsidies, or price-support programs have big stakes and develop powerful bargaining strengths. The process may lead to desirable things part of the time, for log-rolling may help minorities protect their rights or achieve good things for which they are willing to pay a high price. In secret ballots, which could prevent any trading, majorities might well make laws to suppress individual rights for various minority groups. Perhaps many uneconomic or inequitable policies are simply part of the cost of protecting individual rights in a majority-rule society. But the main point is clear: this "price mechanism" in government performs most imperfectly. Often groups that in the aggregate

are affected greatly, can bargain only weakly, and the "price-tags" that become attached to various actions are far from the "right" mark. Thus costs and gains as felt by officials can indeed diverge, and perhaps seriously, from total costs and gains.

It is fairly easy to think of examples. Consider the lease of rights to drill for oil in the deep waters offshore from Los Angeles. The City Council awarded such a lease several years ago. From the standpoints of at least a majority of the Council, the gains from this action outweighed the costs. When Mayor Yorty was elected, however, he felt differently. In fact he had the City Planning Commission zone most of these deep waters "for residential use only" to prevent any drilling; and then apparently considered awarding off-shore leases for other ocean areas. In such situations it is hard to believe that everyone is looking at costs and rewards from the same over-all viewpoint. It reminds me of the typesetter's Freudian slip when a New York paper stated in a different situation: "This will not hurt the mayor, some feel, in that he can say he was always on the side of the angles."

More seriously, though, in connection with almost any government decision, it is instructive to try putting yourself in various officials' places -- Senator A, Governor B, Secretary of Department X, Chief of Branch Y -- and imagining the gains and costs of alternative actions as you would perceive them. The magnitudes cannot be measured, but judgment suggests that serious divergences are pervasive, that checks and balances are crucial in preventing the outcomes from being disastrous, and that it may be possible to devise better bargaining arrangements yielding significantly improved cost-reward structures.

Perhaps the most important divergences between individual and total costs stem from the fact that government officials are spending other people's money. Almost no participant in the budget-formulation process is guided by a cost-reward structure that is in line with total costs and gains. The deck appears to be stacked in favor of gradual budget growth. First, there are groups of firms and individuals who find it worthwhile to press for favors. (One of the failures of

marginal productivity theory is to consider the marginal productivity of effort devoted to obtaining favors from government.) Second, government personnel find these and other expansions attractive. For example, if the head of a bureau or department gets an increased budget, he reaps significant rewards: he can do a better job, or satisfy pressure groups, have greater influence, increase his chances for advancement, and so on. The costs include mainly effort devoted to appeasing rival department heads (usually by making his strategy consistent with the growth of other departments too), and efforts devoted to getting Congressional support. If anything akin to the real resource cost enters into the calculations, it must do so by way of constraints from above.

When we turn to control by top levels of the executive branch, however, we find that here, too, spending other people's money pays. A government can win support by spending in strategic places and spreading the cost thinly over a large group of taxpayers. Tacit coalitions arise, and the restraint once exercised by Treasury Control in Great Britain and by the Bureau of the Budget here is gradually eroded.* But what about the top legislative body? Do members of Congress feel the real resource costs and transmit to government a corresponding constraint? No, as long as they don't go wild, they too can get more points by judicious spending than by voting against tax increases. Imagine that you are a Senator, and compare the points you would score if, apparently singlehanded, you promoted a Home-State River Project with the points you would rack up if you, along with several hundred other Representatives and Senators, reduced each voter's tax bill by \$10.

* See W. Drees, Jr., On the Level of Government Expenditure in the Netherlands after the War, H. E. Stenfert Kroese, N.V., Leiden, 1955, pp. 61-71; Alan T. Peacock and Jack Wiseman, Growth of Public Expenditure in the United Kingdom, A Report of the National Bureau of Economic Research, Princeton University Press, Princeton, N.J., 1961; and Alan T. Peacock, "Economic Analysis and Government Expenditure Control," in Alan T. Peacock and D. J. Robertson (eds.), Public Expenditure Appraisal and Control, Oliver & Boyd, Edinburgh, 1963.

So much for this fragment of cost-reward structures within government. What about the taxpayer? Doesn't he feel the real resource costs and bargain for restraint? Let us look at the costs and rewards, from his standpoint, of pressing for tax reduction or opposing a tax increase. The gains from success in such an endeavor might amount to \$100, but the probability of an individual influencing the outcome is infinitesimal. The expected gains from an individual's effort to oppose a tax increase, therefore, are virtually zero. In these circumstances, how much effort will he devote to bargaining?

Thus it may be that no one feels a cost that adequately reflects the real cost of budget increases. It is hardly surprising, therefore, to find that you as taxpayers are helping to put up a million dollars to rebuild the town of Wink, Texas, and half a million dollars to build a stadium in Bridgeport, Connecticut. Some people regard the latter example as being symbolic because Bridgeport was the original home of P. T. Barnum. But even if you believe such Federal subsidies are wrong, no one is necessarily being a sucker, and no one is necessarily behaving in a reprehensible fashion. Gradual expansion of central government is probably where utility maximization leads with the divergences between individual and total costs that exist under present institutional arrangements.

What can and should be done to reduce such divergences? Many devices may be worth considering -- e.g., having numerous Congressmen-at-large, elected by the whole nation; agreeing, because of our long-run interests, to have paid oppositions; or agreeing to have a "tax-payers' union," with closed shop and check-off system. Perhaps most of all at this point, though, we need to acquire a better understanding of the costs and rewards that organizational personnel find attached to alternative choices. In our familiar competitive model with its cost-reward structures, utility-maximization leads to fairly good outcomes. When you put governmental units (or an international community of governments!) into the model, however, where does utility maximization lead? And where would it lead under modified arrangements affecting the various divergences between individual and total costs and gains?